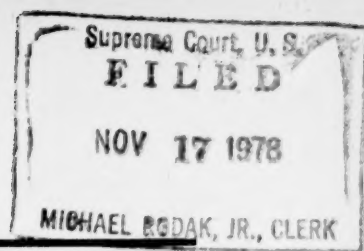


No. 78-321



In the Supreme Court of the United States

OCTOBER TERM, 1978

CHARLES E. PARKER, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

***ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF CLAIMS***

**MEMORANDUM FOR THE UNITED STATES
IN OPPOSITION**

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

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The sole question presented in this federal income tax case is whether the Court of Claims correctly allocated amounts received by petitioners¹ in settlement of a suit between nontaxable "property acquired by gift, bequest, devise, or inheritance" and taxable income from property.

The pertinent facts are as follows: Petitioners are the only children of Esther Segerstrom Meyer, who died in 1928 (Pet. App. B, 2, 11). Esther was the daughter of Charles J. and Bertha Segerstrom (Pet. App. A, 3). Prior to his death in 1928, petitioners' grandfather had been engaged in the business of farming. The family partnership he formed continued the business after his

¹"Petitioners" refer to Robert I. Meyer and his sister, Marilyn E. Parker. Their spouses are parties to this action because they filed joint returns for the year at issue (Pet. 5; Pet. App. A, 2).

death and, at the time petitioners' grandmother died, was farming approximately 2,000 acres of land, with petitioners' grandmother as one of the partners.

Petitioners' grandmother died intestate in 1944. At that time, no formal administration of her estate occurred. However, in 1951, a California Superior Court determined that state inheritance taxes were owing on a 110-acre farm, the "Home Ranch," which certain of her children had received shortly after her death (Pet. App. A, 4-5).

In the early 1960's, petitioners began to question whether they might not have had certain rights to property in their grandmother's estate. Members of the Segerstrom family thereafter filed a suit to quiet title seeking to resolve these questions. Petitioners filed a counterclaim, alleging that they were entitled (1) to a one-ninth share in the Home Ranch, (2) to a one forty-fifth ownership interest in any real estate held by the family partnership, (3) to compensatory damages of \$5 million for the loss of "the use, enjoyment, rents," and profits attributable to their interest in the estate and (4) to punitive damages of \$10 million (Pet. App. A, 6, 13-14). This suit was settled at the pretrial stage, pursuant to which petitioners each agreed to accept \$175,000 in full satisfaction of all claims against the property or the Segerstrom heirs (Pet. App. A, 7). They further conceded that their allegations of fraud, misrepresentation and concealment were untrue and without merit (Pet. App. A, 7, 13).

On audit, the Commissioner of Internal Revenue determined that the settlement transaction was a sale of petitioners' rights in their grandmother's estate. He first determined that the rights each petitioner had to the

estate were worth \$45,202 in 1944² and fixed their bases in the property in that amount. He then added the \$40,000 each of the petitioners had expended in attorney's fees to petitioners' bases, thereby concluding that petitioners each should have recognized long-term capital gain of \$89,798 (\$175,000 less \$85,202) (Pet. App. A, 17).

Petitioners paid the tax, filed claims for refunds and then instituted this action in the Court of Claims (Pet. 6). The court held that the tax character of petitioners' settlement proceeds should be determined by the nature of the claims they asserted in their counterclaim (Pet. App. A, 11, 13). It concluded that petitioners' counterclaim presented essentially three grounds for recovery:³ (1) an inheritance claim to a one-ninth interest in the Home Ranch; (2) an inheritance claim to a one forty-fifth interest in the family partnership; and (3) a claim to income earned by those property interests between 1944 and 1965 (Pet. App. A, 14-15, 18). The court determined that \$145,000 of each petitioner's recovery was attributable to their claims to property interests in the farm and partnership and that the remaining \$30,000 each received was attributable to their claims to income. The court further determined that the property interests claimed had a fair market value of \$29,000 in 1944 as of the grandmother's death and that they should be accorded a \$29,000 basis in those interests for tax purposes. It then apportioned the \$40,000 in legal fees each of the petitioners incurred in prosecuting their counterclaim

²This value was determined by a private tax research firm selected by petitioners' counsel, and approved by the District Conferee of the Internal Revenue Service.

³Since petitioners had stipulated in the settlement agreement that the Segerstrom family had not defrauded them of their inheritances, the court concluded that none of the recovery was attributable to that element of petitioners' counterclaim.

between the respective elements of their recovery—\$31,720 to the recovery of property interests and \$8,280 to the recovery of income—and permitted them each to add \$31,720 to their bases in the inherited properties and to claim an ordinary deduction for \$8,280. The court therefore concluded that petitioners each had realized \$84,280 in capital gains on the disposition of property rights effected in the settlement (\$145,000 recovery minus (\$29,000 basis plus \$31,720 in attorneys' fees)) and \$21,720 in ordinary income (\$30,000 recovery less \$8,280 in deductible attorneys' fees) (Pet. App. A, 18).

The decision of the Court of Claims allocating petitioners' recovery between taxable and non-taxable shares is in accord with *Lyeth v. Hoey*, 305 U.S. 188 (1938). There, this Court held that the tax character of proceeds realized in the compromise of a law suit claiming property in an estate should be determined by reference to the nature of the claim "which underlay the compromise * * * and was recognized by it" (*id.* at 196). Accord: *Bath v. United States*, 480 F. 2d 289, 292 (5th Cir. 1973); *Raytheon Production Corp. v. Commissioner*, 144 F. 2d 110 (1st Cir.), cert. denied, 323 U.S. 779 (1944); *Carter's Estate v. Commissioner*, 298 F. 2d 192 (8th Cir.), cert. denied, 370 U.S. 910 (1962).

The Court of Claims correctly applied this principle. It first assessed the nature of each of petitioners' various claims and apportioned the compromise among them. It then determined the tax character of the recovery in accordance with the nature of the claim "which underlay * * * [that item of] compromise." *Lyeth v. Hoey, supra*, 305 U.S. at 196. Once having made these determinations, it held that: (1) the portion of the compromise payment traceable to petitioners' recovery of income generated by the assets was taxable to them as ordinary income; and (2)

the full date of death fair market value of the property interests petitioners inherited from their grandmother was excludable as property acquired by "gift, bequest, devise, or inheritance" within the meaning of Section 102 of the 1954 Code.

The record refutes petitioners' argument that there was no taxable exchange. Petitioners' claims to a one-fifth ownership interest in the Home Ranch and to a one forty-fifth ownership interest in the family partnership were claims "which underlay the compromise * * * and [were] recognized by it." *Lyeth v. Hoey, supra*, 305 U.S. at 196. As the court below found, when those claims had vested in petitioners at the time of their grandmother's death in 1944, they had had a fair market value of \$29,000. More than 20 years later, in 1965, petitioners agreed to waive those claims for \$145,000 in cash. That case settlement payment was unquestionably in "exchange" for petitioners' claims so that a substantial portion of that payment was taxable gain.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

NOVEMBER 1978